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Nos. 72-486 and 72-488

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

FEDERAL POWER COMMISSION,

Petitioner

v.

MEMPHIS LIGHT, GAS AND WATER DIVISION, *et al.*

TEXAS GAS TRANSMISSION CORPORATION,

Petitioner

v.

MEMPHIS LIGHT, GAS AND WATER DIVISION, *et al.*

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE PUBLIC SERVICE COMMISSION FOR THE STATE OF NEW YORK IN OPPOSITION

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TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
STATUTE INVOLVED	2
QUESTIONS PRESENTED	2
STATEMENT	3
ARGUMENT	7
CONCLUSION	12

TABLE OF AUTHORITIES

Cases:

Alabama-Tennessee Natural Gas Co., 31 FPC 208 4

Alabama-Tennessee Natural Gas Co. v. Federal Power Commission, 359 F.2d 318 (C.A. 5), *certiorari denied*, 358 U.S. 847 ..... 4, 9, 11

Amere Gas Utilities Co., 15 FPC 760 3

City of Chicago v. Federal Power Commission, 385 F.2d 629 (C.A.D.C.) 4

Cities of Lexington, etc., Ky. v. Federal Power Commission, 295 F.2d 109 (C.A.4) 4

El Paso Natural Gas Co. v. Federal Power Commission, *certiorari denied, sub nom.* California v. Federal Power Commission, 366 U.S. 912 ..... 3, 4, 9

Federal Power Commission v. United Gas Pipe Line Co., 386 U.S. 237 3

Midwestern Gas Transmission Co. v. Federal Power Commission, 388 F.2d 444 (C.A. 7), *certiorari denied*, 392 U.S. 928 ..... 4, 8, 9

Statutes:

Revenue Act of 1964, 78 Stat. 35, 26 U.S.C.A. 38 (historical note) 3

Tax Reform Act of 1969, Section 441, 83 Stat. 625, 26 U.S.C. 167(1) ..... *passim*

Miscellaneous:

H. Rep. No. 413, 91st Cong. 1st Sess. 5, 7

H. Rep. No. 782, 91st Cong. 1st Sess. 8

S. Rep. No. 592, 91st Cong. 1st Sess. 5, 7, 9

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OPINIONS BELOW

The opinions of the court of appeals (FPC Pet. Apps. A and B, pp. 17-53) are not yet reported. The opinion of

the Federal Power Commission, No. 578 (FPC Pet. App. D, pp. 57-66) is reported at 43 FPC 824 and its opinion No. 578-A on rehearing, (FPC Pet. App. E, pp. 67-71) is reported at 44 FPC 140.

JURISDICTION

The judgment of the court of appeals was entered on February 18, 1972 and the Commission's petition for rehearing was denied on May 11, 1972. On August 4, 1972, the Chief Justice extended the time for filing a petition for a writ of certiorari to September 23, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

STATUTE INVOLVED

Section 441 of the Tax Reform Act of 1969, 83 Stat. 625, 26 U.S.C. 167(1), is set forth in App. F, pp. 73-78 of the Petition in No. 72-486.

QUESTION PRESENTED

Whether, under the provisions of Section 441(a) of the Tax Reform Act of 1969 providing that natural gas pipelines and certain other utilities who had been utilizing liberalized depreciation with flow through accounting could elect within an 180 day period to shift to normalized accounting for property acquired after January 1, 1970 as long as the property increased the pipeline's productive or operational capacity but did not represent replacement capacity, the Federal Power Commission could authorize a pipeline also to shift to normalized accounting, and thereby increase its rates, with respect to existing and non-expansion property.

STATEMENT

Among the costs of service which a regulated natural gas pipeline or other utility are permitted to charge to their customers in fixing just and reasonable rates are the federal and state taxes, including income taxes, they are required to pay annually. But it is established law that, except to the extent Congress otherwise directs,[1] it is impermissible for the Federal Power Commission to include in a pipeline's cost-of-service an allowance for taxes not actually paid as a result of special tax provisions permitting a pipeline or other regulated company to avoid or reduce the taxes it would otherwise have been required to pay. See *Federal Power Commission v. United Gas Pipe Line Co.*, 386 U.S. 237, 244, 247; *El Paso Natural Gas Co. v. Federal Power Commission*, 281 F.2d 567, 573, (C.A. 5), *certiorari denied, sub nom. California v. Federal Power Commission*, 366 U.S. 912.

In the case of the utilization of liberalized depreciation under Section 167 of the Internal Revenue Code, the Commission originally held that the pipeline's cost allowance for tax purposes should be calculated as though it had paid the higher taxes which would have resulted from its utilization of a straight-line method. See *Amere Gas Utilities Co.*, 15 FPC 760. It did so in part because of its view that Congress had so directed in adopting the provisions for liberalized depreciation in the 1954 Revenue Act, and in part because of a belief that a pipeline's utilization of liberalized depreciation resulted

[1] Thus, in adopting the Investment Tax Credit as part of the Revenue Act of 1964, 78 Stat. 35, 26 U.S.C.A. 38 (historical note), the Congress expressly precluded any federal agency from reducing the pipeline's income tax allowance in any rate case cost-of-service by the amount of the credit, unless the pipeline consented thereto.

in a tax deferral rather than a tax savings. This view of the situation was accepted by several courts of appeals. See *El Paso Natural Gas Co. v. Federal Power Commission, supra; Cities of Lexington, etc., Ky. v. Federal Power Commission*, 295 F.2d 109 (C.A. 4). But in 1964 in *Alabama-Tennessee Natural Gas Co.*, 31 FPC 208, the Commission after a comprehensive reevaluation of the situation concluded that Congress in 1954 had not mandated that pipelines be afforded a cost allowance in their rates for taxes not paid, and that when the pipeline's overall tax liability, rather than its obligations with respect to particular items of property, were considered, the utilization of liberalized depreciation, at least for those pipelines maintaining a growing or stable total plant investment, would result in permanent tax savings rather than a mere tax deferral. It accordingly determined that pipelines using liberalized depreciation should "flow through" the resultant tax savings to income, and that the tax allowance in their costs-of-service should be the actual amount of taxes paid. These determinations were expressly upheld in *Alabama-Tennessee Natural Gas Co. v. Federal Power Commission*, 359 F.2d 318 (C.A. 5), *certiorari denied*, 385 U.S. 847. See also *City of Chicago v. Federal Power Commission* 385 F.2d 629, 633-635 (C.A.D.C.); *Midwestern Gas Transmission Co. v. Federal Power Commission*, 388 F.2d 444, (C.A. 7), *certiorari denied*, 392 U.S. 928.

This was the situation which prevailed at the time of Congress' consideration of the Tax Reform Act of 1969. There is no indication that it was one to which Congress objected. The Congress was, however, disturbed by suggestions that, as a result of indications that the Federal Communications Commission and certain state commissions might impute liberalized depreciation with flow through to the components of the Bell System,

those corporations might switch from straight line to liberalized depreciation at a cost to the Treasury of more than a billion dollars. See House Report No. 413, 91st Cong., 1st Sess., p. 131-132. It also was not prepared to accept the recommendation of the Federal Power Commission that pipelines be required to utilize straight line depreciation in the future, in part because "this would result in prompt, substantial, and widespread utility rate increases." *Id.* at p. 132. Accordingly, it adopted provisions regarding the use of liberalized depreciation by regulated utilities such as natural gas pipelines which were calculated "in general to 'freeze' the current situation regarding methods of depreciation," *Ibid.* See also S. Rep. No. 552, 91st Cong., 1st Sess., p. 172.

The issue in this proceeding is the extent to which the Congress made an exception to this general rule to permit pipelines who were on liberalized depreciation with flow through to switch, with the Commission's approval, to normalized accounting, and to increase their rates to include an allowance for the difference between the taxes they actually paid and those they would have paid if they had been utilizing straight line depreciation. The Federal Power Commission, in a proceeding involving a rate increase filing by the Texas Gas Transmission Corporation ("Texas Gas"), concluded that Texas Gas should be permitted to shift to normalization from flow through with respect to all of its property upon which it was and intended to continue to take liberalized depreciation (FPC Pet., App. D, pp, 57-66). The effect of this action was to increase Texas Gas' rates by $4,400,000, most of which related to the increased tax allowance relating to the pipeline's existing plant (R. 2757).

On review, the Court of Appeals for the District of Columbia, after an exhaustive analysis of the language

and legislative history of the Tax Reform Act of 1969, concluded that the bill, as it emerged from the Conference between the Senate and House and as subsequently enacted, deliberately restricted any such option to property acquired by the pipelines after January 1, 1970, which increases their "productive or operational capacity ... and does not represent replacement of existing capacity."[2] To extend such an option to existing non-expansion property would, the Court held, make "meaningless" the express action of the Congress in limiting the scope of the "election" available to pipelines already on liberalized depreciation with flow through, and result in the same type of massive rate increases which had led the Congress to reject the Commission's proposal to require a shift to straight line depreciation. (Under the Commission's 1969 tax proposal, however, the increased rates to pipeline customers would at least have been offset by increased tax revenues, whereas under the Commission's interpretation of the statute, both the Treasury and rate payers would suffer.) It is this determination which the instant petitions seek to have this Court review.[3]

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[2] In view of its construction of the Tax Reform Act of 1969 the Court of Appeals did not find it necessary to pass upon a number of other procedural and substantive challenges to the Commission's decision which had been raised by Memphis Light, Gas and Water Division and the Public Service Commission for the State of New York, the petitioners below.

[3] In No. 72-96, Memphis Light, Gas and Water Division sought review of the Court of Appeals holding, in the same opinion below, that the Commission properly authorized Texas Gas to shift to normalization with respect to its post-1970 expansion property. Certiorari was denied in this case on October 16, 1972.

ARGUMENT

The Court below held that the Tax Reform Act of 1969 permits natural gas pipelines and similar utilities to raise their rates, by shifting from a flow through to a normalized method of accounting for the use of a liberalized depreciation of property for federal tax purposes, only with respect to new expansion property which increases the pipeline's production and operational capacity. In unanimously rejecting the Commission's view that pipeline's utilizing liberalized depreciation could also shift to normalization with respect to their existing plant, the Court acted in accord with the Congressional intent to "in general freeze the current situation regarding methods of depreciation,"[4] an intent which was in turn motivated by Congress' dual objectives of minimizing potential losses to the Treasury or massive increases in utility rates, both of which consequences it feared might otherwise result from regulatory actions, and which led the Congress consciously to restrict agency discretion in a number of aspects. Its decision is clearly correct, and raises no issue of general significance calling for this Court's plenary review.

1. The arguments of the petitioners rest on the fact that the House and Senate versions of the bill both would have authorized the regulatory agencies to permit a company which had been utilizing liberalized depreciation with flow through accounting to shift to normalization with respect to all of its property.[5] Both the

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[4] H. Rep. No. 413, *supra*, at p. 133; S. Rep. No. 552, *supra*, at p. 172.

[5] The Commission does not contend that Congress could not limit its regulatory discretion through an amendment of the applicable tax laws. On the contrary, its brief in opposition in No.

Commission and Texas Gas ignore the very much more limited election to shift from liberalized depreciation with flow through which emerged from the Conference and was ultimately adopted into law. This election was expressly limited to post-1969 expansion property, with the Conference Report noting that "Even in the case of new property, however, the right to change over from the flow through method is to be available only to the extent that the new property increases the productive or operational capacity to the company." H. Rep. No. 782, 91st Cong., 1st Sess., pp. 312-13.

The petitioners attempt to avoid the effect of the Conference Report, and the language of the Act which resulted therefrom, by suggesting that the 180 day "election" which the Senate bill provided for any shift from liberalized depreciation with flow through was merely an "additional" option, unrelated to the provision in the House bill which would have authorized the Commission to permit a shift to normalization for all of a pipeline's property, new and old. Accordingly, it is contended, the Conference's later limitation of the election to new expansion property did not affect the Commission's discretion to authorize a similar shift with respect to existing and non-expansion property. But the Senate Report does not suggest that it was providing any additional benefit to the pipelines by its 180 day election provision, which it expressly stated was to apply "both as

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72-96 contended that Section 441(a) of the Tax Reform Act of 1969 precludes the Commission from exercising the authority it otherwise had (see *Midwestern Gas Transmission Co. v. Federal Power Commission, supra*) to impute the use of liberalized depreciation with flow through to utilities electing to abandon liberalized depreciation for new expansion property, despite the absence of any express prohibition in the language of the statute.

to new and existing property." S. Rep. No. 552, 91st Cong., 1st Sess., pp. 173-174. Instead it stated that the Senate and House bills "differ" in this "principal area." *Ibid.*

Moreover, as the Court of Appeals indicated (FPC Pet. App. A, p. 38), the construction urged by the Commission and Texas Gas renders "meaningless" the Conference's later action in limiting the election to new expansion property. On the other hand, the construction adopted by the court below is clearly more consistent with the general intent of the Congress to "freeze" the existing situation to avoid either precipitate losses to the Treasury or rate increases to gas consumers. For, while a shift to normalization with respect to new expansion property would have only a gradual effect upon pipeline rates, an unlimited changeover such as the Commission here approved, but Congress acted to forestall, could only serve to add immeasurably to the existing inflationary pressures.

2. Neither the Commission nor Texas Gas has shown that any question of sufficient importance to warrant plenary review by this Court is presented by the Court of Appeals' unanimous construction of the Tax Reform Act of 1969. This Court, in the past, has consistently rejected efforts to review lower court decisions on the rate effect of liberalized depreciation, even where they mandated a significant change in existing industry practices. See *Alabama-Tennessee Natural Gas Company v. Federal Power Commission*, 359 F.2d 318 (C.A. 5), *certiorari denied*, 385 U.S. 847; *Midwestern Gas Transmission Co. v. Federal Power Commission*, 388 F.2d 444, *certiorari denied*, 392 U.S. 928; see also *El Paso Natural Gas Co. v. Federal Power Commission*, 281 F.2d 567 (C.A. 5), *certiorari denied sub nom., California v. Federal Power Commission*, 366 U.S. 912. The lower court's conclusion

here that the Tax Reform Act of 1969 precludes pipelines already using liberalized depreciation and continuing to do so from raising their rates by shifting from flow through to normalized accounting for their existing and non-expansion property, certainly raises no greater public issues.

The Commission suggestion that the decision below impairs its ability "to promote rates" (FPC Petition, p. 10)[6] is without substance. The use of liberalized depreciation by a pipeline with respect to all of its eligible property does not cease to provide permanent tax savings because the pipeline may have the right to treat new expansion facilities, for accounting and rate purposes, as though it had paid taxes on a straight-line basis: it is the continued use of liberalized depreciation rather than the method of accounting therefore which results in the tax savings. There is thus no basis for the Commission's unsupported assumption that permitting present rate increases will avoid future rate increases which would otherwise be necessitated.

On the contrary, even if it was proper to revert to the discredited concept that the actual long range effect of a

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[6]The Commission petition characterizes its action as "perhaps necessitating present rate increases (rather than deferral to future consumers of payments for present tax expenses)" (Petition, p. 15). In fact, the immediate rate increase effect of its action is certain—in the case of Texas Gas approximating $4,400,000—while, as the Commission itself recognized (FPC Pet. App. pp. 63-64), even if its analysis is confined to the pipeline's old and non-expansion plant, (but see text, *infra* at 11), there is no certainty that there will be any offsetting future cost increases. Moreover, any such future increases would *not* involve future rate payers paying for the pipeline's present tax expenses, but only for such increases as might actually be incurred at such time.

company taking liberalized depreciation can be analyzed on a unit of property basis, or through segregated consideration of various portions of a company's property,[7] there is no reason to believe that there will be any net increase in future taxes as a result of the use of liberalized depreciation. For the rate base applicable to such property at the future date when higher taxes would theoretically be due thereon—which in the case of Texas Gas is estimated to be thirteen years after the rate case test year—would be substantially less than that upon which the higher present calculations are made. Moreover, the Internal Revenue Service treats as present income any revenues a pipeline is permitted to collect because its rates have been calculated as if it depreciated its property on a straight line rather than liberalized basis. Accordingly, in order to make up for this tax-on-tax effect, the immediate increase in the pipeline's rates is substantially more than the difference between the taxes actually paid and those it would have paid on a straight line basis.

[7] But see *Alabama-Tennessee Natural Gas Co. v. Federal Power Commission, supra*, 359 F.2d at 328.

CONCLUSION

For the reasons set out above, the petitions for a writ of certiorari should be denied.

Respectfully submitted,

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